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Mr. Chairman and members of the Committee, I appreciate the opportunity to discuss important fiscal policy issues, especially as they relate to younger Americans. Like all citizens, young people benefit from good fiscal policy and suffer if fiscal policy heads in the wrong direction. And younger Americans clearly have the most to gain – or to lose – depending on whether fiscal policy improves or deteriorates in the future.

These are not terribly controversial statements. The real challenge is how we define "good" fiscal policy and "bad" fiscal policy. These issues probably will never be resolved, but allow me to set our four principles that should guide the discussion:

1. **The size of government matters, not the deficit.** Policy makers often focus on the symptom of bad fiscal policy and ignore the underlying cause. The real problem is that government is too big. How we finance that government is a secondary concern. Taxing and borrowing are two ways to finance government, and both have adverse consequences, as resources are transferred from the productive sector to government. Although some government expenditures, such as providing national security or maintaining a well-functioning legal system, bring societal benefits that compensate for the economy's forgone growth, in many cases, the rate of return on government spending is very low--or even negative. Some argue that deficits are an especially bad way to finance government since there may be an adverse impact on interest rates, but empirical evidence does not support this assertion. Interest rates are determined in world capital markets where trillions of dollars change hands every day. Even a large shift in the U.S. government's fiscal balance is unlikely to have a noticeable impact on interest rates. Indeed, interest rates have fallen in recent years even though the federal government now has a $300+ billion deficit instead of a $200+ billion surplus. This does not mean that higher deficits lead to lower interest rates. Instead, it shows that other factors have a greater impact than deficits. Academic studies have confirmed that there is no significant relationship between fiscal balance and interest rates.

2. **Long-run deficits are the result of too much spending, not tax cuts.** During the 50 years from 1951 to 2000, federal tax revenues averaged 18.1 percent of gross domestic product (GDP). Opponents of tax relief frequently imply that tax cuts have emptied government coffers and created long-term fiscal chaos, but tax revenues for 2012-2014 will average 18.0 percent of GDP even if the Bush tax cuts are made permanent, according to Congressional Budget Office (CBO) data. Moreover, the CBO estimates that revenues will climb higher in subsequent years. America does have a long-run deficit, but that is solely the result of projected increases in government spending. And it is this estimated increase in the burden

of government that demands our attention, not the deficit that it will create. To protect America's interests – and to generate economic growth that will benefit younger Americans, policy makers should concentrate on reducing the burden of government spending.

3. **The current deficit is trivial compared to long-run unfunded liabilities.** To the extent that policy makers want to fixate on current deficits, they are focusing on the molehill and ignoring the mountain. In just the past 40 years, entitlements have nearly doubled as a share of federal outlays, climbing from 32 percent of total outlays in 1962 to 60 percent of the federal budget in 2002. But the problem will soon get much worse. According to the Congressional Budget Office, mandatory spending for Social Security and Medicare will nearly double as a share of the gross domestic product (GDP) over the next 40 years. The net result will be huge long-term deficits, and Medicare is the main problem. According to the trustees' reports on Social Security and Medicare, the combined deficit of the two programs will swell to more than 8 percent of national economic output in 2075, with Medicare accounting for about three-fourths of the red ink. According to government data, the Social Security cash-flow deficit through 2078 is $25.85 trillion in today's dollars. But this is spare change compared to the Medicare cash-flow deficit, which is a staggering $111.4 trillion over the same period.

4. **Entitlement programs are bad deal for younger Americans.** The looming explosion of entitlement spending might be justified if the programs were providing a lot of "bang for the buck." Unfortunately, this is not the case. Social Security, for example, is deteriorating into a bad investment for workers. People are paying record amounts of tax money into the program during their working years, but the benefits they are promised (which they may not get) are relatively meager by comparison. The Social Security payroll tax has climbed to 12.4 percent. Little wonder average workers now pay more in Social Security taxes than they send to the IRS. But benefits have not grown nearly as fast. Workers used to get back all the taxes they paid -- plus interest -- after spending just a few years in retirement. New retirees, by contrast, will have to collect benefits for decades to get their money back. And those just entering the workforce will have to live past 100 to get a decent return from Social Security. Of course, even these bleak forecasts assume Social Security will find the $20 trillion it needs to pay promised benefits.

Thank you for the opportunity to discuss these important issues. I would be happy to answer any questions.